No. 18,786

IN THE

United States Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

vs.

FIRST SECURITY BANK,
Appellee.

On Appeal from the Judgment of the United States District Court for the District of Montana

BRIEF FOR THE APPELLEE

GALUSHA AND MELOY,
FRANCIS GALLAGHER,
JOHN R. KLINE,
P. O. Box 1699, Helena, Montana,
Attorneys for Appellee.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

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STATEMENT OF FACTS

The government's statement omitted many essential items of fact on which Judge Jameson based his opinion. In the interest of brevity the appellee adopts the full text of the facts set forth in the District Court's opinion. The government in its statement of facts deleted parts of the District Court's statement on pages 14 through 18 of the Record in reference to the evidence as to the existence of the partnership and its operation of the insurance business which led the lower Court to make the following comments:

> "There is no question in my mind that the stockholders of the bank intended to create a partnership and understood that they were operating the insurance business as a partnership during the years in question." (Record, page 18.)

and the following conclusion:

> "It is my conclusion that plaintiff has assumed its burden of showing that a partnership did in fact exist, whether or not the written articles of co-partnership were executed by all of the partners, and that the partnership did in fact operate the insurance agency during the years in question." (Record, page 21.)

SPECIFICATION OF ERROR

In the trial before the District Court the government contended as follows:

> "Defendant contends (1) that the plaintiff failed to prove that the stockholders did in fact form a partnership and (2) that if the court finds that the stockholders did create a partnership which operated the insurance agency, the income from that agency is still taxable to the bank, since it is not a partnership recognizable for tax purposes as an independent taxable entity apart from the plaintiff." (Record, page 20.)

In this Court the government now contends as follows:

> "The District Court erred:
>
> 1. In holding that the income from the insurance business was allocable to the partnership and not to the bank.

2. In deciding this case in favor of the taxpayer." (Appellant's brief, page 7.)

It would appear on reading the appellant's specification of errors on appeal that the government has adopted the District Court's finding that the partnership did in fact exist and operated the agency.

As we read the appellant's brief, however, it seems that it is still contending that the District Court erred in finding that the partnership existed and conducted the insurance business. The stated basis for the appellant's apparent contention is that the record does not show a transfer of the insurance business to the partnership prior to 1957. Judge Jameson's Conclusion of Law Number 3 (Record, page 38) that the partnership did operate the insurance business is based on the uncontradicted evidence that the bank stopped selling insurance at the end of 1945. The uncontradicted testimony of C. H. Brocksmith, the principal officer of the bank (Record, page 49), is as follows:

"Q. And commencing at the time of the purchase, from 1942, did the bank engage itself as an agent to sell insurance?

A. Yes, sir.

Q. And for how long did the bank sell insurance?

A. Through 1945.

Q. As I understand your testimony then, the bank stopped selling insurance in 1945?

A. Yes, sir."

The uncontradicted testimony of C. H. Brocksmith, a member of the partnership, that the partnership

commenced selling insurance beginning in 1946 is as follows:

"Q. In 1946 I believe you testified that you engaged in the insurance business as a partner, is that correct?

A. Yes, sir.

Q. And by that I am sure that you intended that it be separate and apart from the bank?

Mr. Schwalb. Objection.

The Court. Objection sustained.

Q. What was your intent as far as the conduct of the insurance business was concerned?

A. To completely separate it from the bank business.

Q. And engage as a partnership?

A. Yes, sir."

ARGUMENT

We agree with the government in its statement on page 17 (Appellant's brief) to the effect that each case in this area must necessarily turn upon its own facts.

The Appellate Court is primarily concerned with the review of the District Court's interpretation of statutes or constitutional provisions or controlling decisions. Other than the application of Section 482 I.R.C., the only contention being made by the appellant is one involving the factual determination of the District Court.

Rule 52 (a) of the Federal Rules of Civil Procedure is applicable here.

"Rule 52. Findings by the Court.

(a) Effect. In all actions tried upon the facts without a jury . . . . Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

U. S. v. United States Gypsum Co., 68 S. Ct. 525;

U. S. v. Rosebrook, 318 Fed. 2d 316 (9th 1963);

Chism's Estate v. Commissioner of Internal Revenue, 322 Fed. 2d 956 (9th 1963);

Campagna v. U. S., 290 Fed. 2d 682 (9th 1961).

We urge the application of Rule 52 (a) on the basis that there is ample evidence to support the District Court's finding of fact.

KIMBALL[1] AND CAMPBELL[2] CASES

There are really only two cases wherein Courts have considered circumstances of fact which are closely related to the case under consideration. We do not wish to burden this Court with an analysis of those cases, as Judge Jameson has so ably analyzed them that further comment is unnecessary. We do wish to point out the misconstruction of the appellant of those two cases, as follows:

(1) As a point of argument and claimed construction of the *Campbell* case, the appellant states on page

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[1]*Bank of Kimball v. United States,* 200 Fed. Supp. 638.

[2]*Campbell County State Bank, Inc. v. Commissioner,* 37 T.C. 430, reversed 311 Fed. 2d 374 (8 Cir.).

17 of its brief that the bank in the *Campbell* case never owned the insurance business, while the fact is, and as pointed out by Judge Jameson, that the bank in the *Campbell* case in effect operated the insurance agency the first year.

(2) In commenting on the *Kimball* case, the appellant leads the Court to believe that the reason the District Court found for the government was that there was no showing that in 1951 there was a transfer of the insurance business. This may have been a factor in determining that the partnership did not exist but the appellant overlooked the important facts of the *Kimball* case which distinguish it from the present case in that in the *Kimball* case no partnership returns were filed, the Board of Directors passed motions governing the operation of the alleged partnership and commissions were paid pursuant to motion of the bank directors. Such facts do not occur in the case on this appeal.

Other than the *Kimball* and the *Campbell* cases, the only case which the appellant cites which relates to the fact issue here is the case of *Nichols Loan Corp. of Terre Haute v. Commissioner* (P-H TC Memo 1962-149, 21 TCM 805) Decision on Appeal 321 Fed. 2d 905 (C.A. 7th). The appellant in its brief states in the note on page 19 that the Tax Court "deemed crucial" the fact the insurance businesses were *not* transferred by preexisting partnerships to subsequently formed finance corporations in its finding that the insurance income was properly attributable to the partnership and not to the corporations. We cannot

find in that opinion any language which would justify the importance the appellant seems to place on the finding the Court made as to the non-transfer of the insurance business to the loan corporations. In the *Nichols* case the partnership existence was never questioned. In fact, while not at issue here, the main issue on appeal was the allocation of expenses, wherein the Court found (quoting from the syllabus No. 1 (321 Fed. 2d 905)):

> "1. Business Expenses—Trade or business—corporations. Business expenses attributable to credit insurance were deductible as ordinary and necessary expenses of small loan corporations. It was advantageous to these seven corporations to have credit insurance available to their customers for a 'one-stop' service in borrowing. Availability of the insurance was essential to meet competition, it reduced bad debt risks, and the customers wanted it. Making insurance available was sound business judgment and all overhead expenses of the insurance portion of the business were deductible as ordinary and necessary expenses of the loan business. Reference: 1963 P-H Fed. 11,018 (5)."

Other than the *Campbell, Kimball* and *Nichols* cases, the cases cited by the appellant have no particular application to the facts considered on this appeal. For example, the government, in referring to the Brocksmith letter set out in the appendix, states on page 13 of its brief:

> "While the arrangement may have been sufficient to satisfy the state law requiring a separa-

> tion of the insurance business from the banking business, it was not sufficient to enable the bank to avoid being taxed on income which, in reality, it earned."

Cases are cited. When the appellee examined these cases it thought there would be cases involving state law preventing the conduct of certain businesses. All that these cited cases hold is that tax must be paid by the entity that operates the business, a rule with which we have no quarrel. Judge Jameson, on substantial evidence, has found and held that there were two entities conducting separate distinct businesses. Brocksmith, in the letter, demonstrates and urges that banks be allowed to operate agencies and gave his reasons, but laments the fact that it cannot be done and was not done by the appellee after the pressure of the insurance companies and the attorney general caused the separation.

APPLICATION OF SECTION 482

The District Court held that the partnership did exist and did conduct the insurance business. No reason is given by the appellant to show that these findings of fact are arbitrary and thus the question of the application of Section 482 must be applied to the factual situation wherein we have two entities, one conducting the insurance business and the other conducting the banking business and both entities owned by the same individuals.

Section 482 defines its own application. Such application and reason for enactment is commented on by this Circuit Court in *Rooney v. U.S.,* 305 Fed. 2d 681 as follows:

> "The legislative history indicates that the predecessor of Section 482 was designed to prevent the avoidance of tax or the distortion of income by the *shifting of profits from one business to another.* (H. Rep. No. 2, 70th Cong., 1st Sess., p. 146 (1939-1 Cum. Bull. (Part 2) 384, 395); S. Rep. No. 960, 70th Cong., 1st Sess. p. 24 (1931-1 Cum. Bull. (Part 2) 409, 426)). See Asiatic Petroleum Co. v. Commissioner, (2 Cir. 1935) 79 F. 2d 234, 236-237 (16 AFTR 610); cert. den. 296 U. S. 645. This purpose is effected if the taxpayers are commonly controlled when they deal with each other; control at another time is unimportant. Section 39.45-1 (c) of Treasury Regulations 1184 supports this view in stating that transactions between controlled taxpayers will be subject to special scrutiny." (Italics supplied.)

It is manifest that the insurance business is a separate business from the banking business and the two entities did not deal with each other and there was no shifting of profits from one to the other.

The District Court (Record, page 27) recognized this cardinal principle of the application of Section 482 when it stated:

> "This case, as presented, does not involve an allocation of expenses pursuant to Section 482. It would seem that a reallocation could properly have been made with respect to any items of expense which might under appropriate evidence 'be reasonably considered expenses attributable

> to the insurance partnership.' Campbell County State Bank v. C.I.R. 8 Cir. supra."

The lower Court's comment is in accord with the *Rooney* case (supra).

We call attention to the words of the appellant which ask for a reversal of the District Court.

Page 11, Appellant's Brief:

> "We do not contend that there must be some evidence of a transfer of the insurance business to the partnership before the lower court can conclude that the bank divested itself of that business."

The appellee contends that the District Court fully considered this.

Page 12, Appellant's Brief:

> "Our position that the insurance business was never transferred to the partnership is not inconsistent with any direct finding by the lower court."

It is the appellee's contention that this was considered by the District Court and found not decisive.

Page 13, Appellant's Brief:

> "In addition to the absence of evidence showing that the bank transferred the insurance business to the partnership, the conclusion that the bank never divested itself of the business is supported by the fact that the bank continued to treat the insurance business as its own business."

The appellee contends that the evidence is in direct opposition to the conclusion of the appellant.

Page 15, Appellant's Brief:

> "Moreover, and of particular significance, is the fact that the bank treated the insurance income as its own income."

(This is a reckless and unwarranted statement not supported in one scintilla by the Record.)

Page 16, Appellant's Brief:

> "Finally, the fact that the bank had a valid business reason for separating the insurance business from the banking business does not foreclose the Commissioner from allocating the income to the bank to clearly reflect its income."

The appellee does not rely on this fact alone, but only that it is indicative of the motive for the separation of the businesses.

Page 17, Appellant's Brief:

> "whether the bank ever ceased to own the insurance business after the formation of the partnership."

There is direct testimony that the bank ceased selling insurance.

In effect, what the government actually contends is that the District Court erred in the conclusion that a partnership existed and did sell insurance. The only reason assigned is that there is no evidence of a sale or transfer of the insurance business to the partnership.

The facts and undisputed facts are summarized as follows:

(1) In 1945, the bank, a Montana corporation, found that it was against the Montana law to sell insurance (direct testimony (Record, pages 49, 50)).

(2) Insurance companies refused to permit banks to act as their agents (direct testimony (Record, pages 50, 54)).

Numbers one and two above are the motives for the change—not tax evasion as contended by the government.

(3) At the end of 1945 the bank stopped selling insurance (direct testimony (Record, page 49)).

(4) In 1946 a partnership was formed and it did sell insurance (direct testimony (Record, pages 50, 51)).

(5) Contrary to the *Kimball* case and in line with the *Campbell* case, there is no evidence that the board of directors of the appellee bank exercised any proprietary functions as to the conduct of the insurance business.

(6) The partnership kept separate accounts, books, files, stationery, bank deposits, and had separate correspondence. (Record, page 78.)

(7) The actual cost of the running of the agency was small, the capital requirements none (Record, page 62, Finding No. 15 of Trial Court Record page 34), and the appellee bank considered the agency brought business to the bank and was willing to provide desk, file space and some clerical help in exchange for this advantage. (Record, page 92.)

(8) Partnership income was kept segregated and distributed to the partners each year so that there were no accumulated earnings. (Record, page 67.)

(9) Partnership income tax returns were filed showing the income of the partnership. (Record, page 123.) The government has not questioned the fact that the partners paid tax on their partnership earnings. (Record, page 106.)

(10) The insurance agency was given to the bank in 1942 without consideration and though there is no proof in the record as to the value of the insurance business, four years later, in 1946, what it was worth in 1957 is no indication that the insurance business had saleable value in 1946. If the government feels that it did have value in 1946 and was in effect distributed to the stockholders, then the government's remedy would be by way of a tax to the stockholders as a dividend.

CONCLUSION

It is our contention that the record amply sustains the District Court's finding that the partnership existed and it did sell insurance. If this Court sustains this contention, then the only issue is the application of Section 482. The only two cases on similar facts *(Kimball* and *Campbell)* say the bank is not to be taxed on the insurance earnings.

We think that this Court should, in unequivocal terms, tell the Commissioner of Internal Revenue that Section 482 is not and was never intended as authority to *combine* income of separate entities but

merely to see that the income of the insurance business did not include bank income and vice versa, that the bank income did not include insurance income, or as Judge Jameson points out, that if the bank is claiming a deduction for light, telephone, etc., which was attributable to the insurance partnership, such deduction may be disallowed to the bank under Section 482. This course was not pursued by the government here.

We are of the opinion that the government has failed to demonstrate to this Court that under Rule 52 the District Court's Findings and Conclusions are clearly erroneous.

Dated, Helena, Montana,
February 28, 1964.

Respectfully submitted,
GALUSHA AND MELOY,
FRANCIS GALLAGHER,
JOHN R. KLINE,
Attorneys for Appellee.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated this 28 day of February, 1964.

PETER MELOY.